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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 228

THE S. S. WHITE DENTAL MANUFACTURING COMPANY,

Petitioner,

vs.

THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

The petitioner prays that a writ of certiorari issue to review the judgment of the Court of Claims in the above case.

Opinion Below.

The opinion of the Court of Claims is reported in 38 Federal Supplement 301.

Jurisdiction.

The judgment of the Court of Claims was entered April 7, 1941. The jurisdiction of this Court is invoked under Section 3(b) of the Act of February 13, 1925, as amended.

Question Presented.

The sole question presented is whether the petitioner, in arriving at its net income for 1936 subject to Federal income and undistributed profits tax, is entitled to deduct an allowance for obsolescence. It claims this allowance to recover part of the undepreciated cost, less salvage value, of an old plant which it abandoned upon the erection of a new plant, as an addition to an existing one in another city, to take its place.

Statutes Involved.

The applicable portions of the statutes and the regulations and rulings of the Commissioner of Internal Revenue thereunder, are set forth in the appendix, *infra*, pp. 9-11.

Statement.

During 1936, petitioner carried on its manufacturing operations in two plants in Pennsylvania, one at Frankford and the other at Northwood, and in its plant at Staten Island in the City of New York. In 1936 and 1937, the plant at Northwood was in good condition and adequate for petitioner's manufacturing operations (Finding 2). At a meeting of the Executive Committee of the petitioner on April 1st, 1936, resolutions were adopted providing for the transfer of operations in the Northwood plant to Staten Island by the erection of a new building there for that purpose, consideration later to be given to the transfer also of Frankford's operations, the entire consolidation program to effect economies estimated at $110,000. a year. The result to be obtained from the removal from Northwood was an estimated annual saving in expense of $30,649 (Finding 3).

The petitioner entered into contracts for the erection of the new plant in 1936 at a maximum cost figure of $207,800.

The new plant was completed by April 1st, 1937 and all departments of the Northwood plant were moved into it on or before May 1st, 1937. The Northwood plant was thereupon vacated and abandoned and was not thereafter used by petitioner (Finding 4).

On April 1, 1936, the date petitioner determined to abandon the plant at Northwood, its cost, less depreciation previously allowed by the Commissioner of Internal Revenue, was $170,504.45 (Finding 9), its salvage value at date of abandonment a year later was estimated to be $75,000, which was found by the court to be reasonable (Finding 5). Petitioner kept its books and filed its income tax returns on an accrual basis of accounting (Finding 8). It claimed, after its return for 1936 was filed, an allowance for extraordinary obsolescence measured by the difference between the depreciated cost of the Northwood plant at April 1, 1936 and the estimated salvage value of $75,000 spread over the period from April 1st, 1936 to April 1st, 1937. This difference amounted to $95,504.45. The petitioner, being on an accrual basis of accounting, claimed three-fourths thereof, or $71,628.34, as applicable to the year 1936, nine of the twelve months' extraordinary obsolescence having occurred in 1936 (Finding 10).

The court below denied this claim.

Specification of Error to be Urged.

The Court of Claims erred in holding that the petitioner was not entitled to the allowance for obsolescence for the year 1936 as claimed by petitioner.

Reasons for Granting the Writ.

The decision of the Court of Claims rests on the assumption that since the Northwood plant was in good condition and adequate for petitioner's manufacturing operations and that its abandonment was part of a larger program to

consolidate all the manufacturing operations, including the Frankford plant of the petitioner, at Staten Island, the obsolescence allowance was inappropriate, because (according to its opinion) "there was no proof that the abandoned property was in fact obsolescent".

An adequate plant may be an obsolescent one when measured in terms of efficiency and economy. The opinion of the court below in a footnote discloses that the old plant occupied ten buildings, an arrangement characterized as outmoded by petitioner's expert witness, a characterization to which the opinion below assigns insufficient weight. The new plant was under one roof. The replacement, it was estimated, would save $30,649 a year. This abandonment and replacement, the petitioner submits, is supersession and gives rise to statutory obsolescence.

This Court in a definition of statutory obsolescence (i. e., obsolescence within the intendment of Section 234(a)(7) of the Revenue Act of 1918, in all respects identical with Section 23(1) of the Revenue Act of 1936 (appendix, *infra*) and corresponding sections of all intervening revenue acts, specifically included supersession as one of the causes entitling a taxpayer to an allowance for obsolescence. This definition, now become standard, occurs in the case of *U. S. Cartridge Co.* v. *United States,* 284 U. S. 511, 516. Said this Court:

> "Obsolescence may arise from changes in the art, shifting of business centers, loss of trade, inadequacy, supersession, prohibitory laws and other things which, apart from physical deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value."

This Court very recently amplified and supplemented this definition of statutory obsolescence in a case brought under the Revenue Act of 1928 involving the sole question of statutory obsolescence. In the case of *Real Estate-Land*

Title & Trust Company v. *United States*, 309 U. S. 13, 16, this Court, after referring to its previous definition, said:

> "But in general, obsolescence under the act connotes functional depreciation, as it does in accounting and engineering terminology."

citing in a footnote the following authorities:

> "Kester, Advanced Accounting, 3d ed. 1933, chap. 10; Hatfield, Accounting, 1927, Chap. V; Saliers, Depreciation Principles and Applications, 3d ed. 1939, chap. 4; Kester, Depreciation (1924); Transactions, Amer. Soc. C. E., Vol. 81, p. 1527 (1917); Marston & Agg, Engineering Valuation (1936) pp. 83-85."

A concise and representative definition of functional depreciation by these authorities appears at page 1527 of Volume 81 (1917) of "Transactions of American Society of Civil Engineers". It follows:

> "Functional Depreciation.—Depreciation due to inadequacy, obsolescence or supersession.
> Inadequacy.—The insufficiency of a unit to perform fully the function required of it.
> Obsolescence.—The condition or process by which units gradually cease to be useful or profitable as a part of the property, on account of changed conditions.
> Supersession.—The substitution of a more profitable or efficient unit for the existing property unit."

There is no variance, except of language, by the other authorities in defining "functional depreciation". Since the petitioner relies largely on supersession to sustain its claim, it repeats, because of its aptness in the instant case, the definition of the term by Marston & Agg in their "Engineering Valuation" (1936 Edition) at page 84:

> "7. Supersession; in cases where the same service can be rendered with greater efficiency in quite different kinds of structures and/or equipment."

It thus appears clear that this Court has continued its liberal interpretation of the statutory term "obsolescence" begun in *V. Loewers Gambrinus Brewing Co.* v. *Anderson*, 282 U. S. 638, 641, in which it said:

> "The language of Section 234(a)(7) is broad enough to include all obsolescence from whatever cause."

and in its companion case, *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, 654, decided the same day. It is an interpretation to which the Treasury Department itself is committed (Article 23(1)(6) of Regulations 94, appendix).

Other courts and tribunals of lesser jurisdiction consistently have held that obsolescence is allowed under circumstances prevailing in the instant case. *Appeal of American Valve Company*, 4 B. T. A. 1204; *Corsicana Gas & Electric Co.* v. *Commissioner of Internal Revenue*, 6 B. T. A. 565; *Central Savings Bank* v. *Commissioner of Internal Revenue*, 10 B. T. A. 1408; *Conley Tin Foil Corporation* v. *Commissioner of Internal Revenue*, 17 B. T. A. 65; *Beckman* v. *United States*, decided May 3, 1938, by the District Court, E. D. of Penna. (38-1 U. S. T. C. 9295); *Post Office Building Co.* v. *Commissioner of Internal Revenue*, decided July 28, 1939, by the Board of Tax Appeals in a memorandum opinion (Dockets 93083, 93084 and 94464).

The opinion of the Circuit Court of Appeals in the case of *Crooks* v. *Kansas City Title & Trust Co.*, 46 F. (2d) 928, C. C. A. Eighth Circuit, discussed by this Court in the *Real Estate-Land Title & Trust Co.* case, *supra*, relies strongly on two rulings of the Treasury Department, O. D. 381 and I. T. 1775, appendix, *infra*. O. D. 381 is particularly in point here. These rulings have the force of law under the doctrine of this Court in the case of *Helvering* v. *Winmill*, 305 U. S. 79, 83.

While this Court, in the case of *Real Estate-Land Title & Trust Company* v. *United States, supra,* denied an allowance for obsolescence, such denial rested on a special state of facts. The taxpayer abandoned a plant which it had acquired in the very same year and which apparently it never used, or used but slightly.

The rationale of this Court's opinion is contained in the following words:

> "For this is not the case of acquisition of a new plant to take the place of one outmoded or less efficient. Rather the conclusion is irresistible that the plant was discarded only as a proximate result of petitioner's voluntary action in acquiring excess capacity."

In the instant case, petitioner constructed a new plant to take the place of an old one which was in use up to the very moment of its abandonment. The replacement was made to effect substantial economies of operation. This is supersession and hence is within the definition of functional depreciation which this Court holds yields the statutory allowance for obsolescence.

The principle contended for is of great importance to every taxpayer subject to the Internal Revenue laws, and its establishment beyond doubt is highly desirable. The opinion of the court below in the instant case, petitioner submits, does not accord with the liberal rules governing obsolescence established by this Court. A more recent opinion, by the Circuit Court of Appeals, Eighth Circuit, in the case of *Becker* v. *Anheuser-Busch, Inc.,* decided May 29, 1941, discusses the question and these rules exhaustively. While the *Anheuser-Busch* case involved facts and property different from those in the instant case, it is of interest because the court found that there was no abandonment or disuse of the property (bottles, cases, etc.) claimed to be obsolete. It held that the taxpayer under the

state of facts proved (non-abandonment) was limited to the annual allowance which includes a reasonable amount for exhaustion, wear and tear, and obsolescence, which allowance, for convenience, according to the article quoted by the court (corresponding to Article 23(1)-1, appendix) is referred to as depreciation. It is the extraordinary obsolescence under Article 23(1)-6 (appendix), additional to this depreciation allowance to which this petitioner is entitled and it submits that the decisions of this Court support the propriety of its claim.

Conclusion.

It is respectfully submitted that, for the reasons stated, this petition for a writ of certiorari should be granted.

J. Henry Walters,
Harry Levine,
Attorneys for Petitioner.

July, 1941.